

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION E-3974

APRIL 13, 2006

R E S O L U T I O N

Resolution E-3974. San Joaquin Local Agency Formation Commission request for a California Public Utility Commission opinion on the effect of South San Joaquin Irrigation District's proposal to provide retail electrical service within Pacific Gas and Electric's service territory.

By letter dated January 11, 2006, and received by the Energy Division on January 18, 2006.

SUMMARY

It is possible that the proposal by the South San Joaquin Irrigation District (SSJID) to provide retail electrical service to approximately 40,000 existing Pacific Gas and Electric Company (PG&E) customers will raise rates for PG&E's remaining customers; the magnitude of any estimated increase, however, is small relative to PG&E's current system average rates, and thus does not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

- Some customers in SSJID's proposed service area may be exempt from payment of certain transition costs and other non-bypassable charges (NBCs) which would require remaining PG&E customers to cover these costs.
- There is a possibility that SSJID's severance proposal may idle some existing PG&E distribution and transmission (T&D) facilities requiring PG&E customers to cover the costs. PG&E did not quantify the impact, however, because it claims such an estimate depends on SSJID's precise plans which are unknown at this time.
- PG&E's remaining ratepayers could be affected by lost T&D revenue that PG&E would have collected from customers in the proposed SSJID service area. PG&E could avoid some T&D costs should the SSJID's proposal

move forward, however, using the most conservative estimate (i.e the largest reasonable estimate adverse to ratepayers), the lost revenue is expected to exceed the avoided costs, so that the contribution to margin would decrease.

- Although the amount of load departure resulting from SSJID's proposal may be within the range of forecasting uncertainty, it does not negate the cost impact analysis.
- To the extent PG&E agrees there are quantifiable avoided costs, its model credits them as a benefit to PG&E's remaining ratepayers; SSJID's claims of additional quantifiable net benefits could further reduce the impact on PG&E's remaining ratepayers.
- The largest estimated total overall quantifiable rate impact of SSJID's proposed service on PG&E's remaining ratepayers is \$0.00037 per kilowatt-hour (kWh), which is approximately $\frac{1}{4}$ of a percent of PG&E's current system average rate.

Consideration of energy policy issues related to the formation or expansion of public power within a public utilities' service territory should be added to the scope of the CPUC's review under Government Code § 56131, and a general policy statement should be formulated.

- The CPUC is seeking legislative changes to expand the scope of its review to require the consideration of the cumulative impacts of additional proposals, including the effect multiple proposals may have on the efficiency of the utilities' programs to implement state energy policy goals and priorities.
- The initiation of a generic CPUC proceeding to consider and adopt a general policy statement is pending.

BACKGROUND

SSJID proposes to expand the scope of the services it offers to provide retail electrical service to approximately 40,000 existing PG&E customers.

SSJID currently provides irrigation water service and wholesale domestic water service to customers within southern San Joaquin County, and also provides wholesale electric generation and electricity marketing services through its ownership interest in three hydroelectric generating facilities. SSJID proposes to

acquire existing electric distribution facilities owned and operated by PG&E, and construct certain new facilities to physically and operationally separate from PG&E's existing facilities, in order to begin providing retail electric service to approximately 40,000 customers. Because SSJID does not currently provide retail electric service, SSJID is seeking approval from the San Joaquin Local Agency Formation Commission (LAFCo).

The CPUC is responsible for investigating SSJID's proposal and issuing an advisory report to the LAFCo on whether it will have a substantial impact upon PG&E's remaining customers.

Government Code § 56131 requires the CPUC to investigate irrigation district proposals and report its opinion to the LAFCo within 90 days whether the proposed service within the proposal territory will substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of its service area. On January 18, 2006, the Energy Division received a letter, dated January 11, 2006, from the San Joaquin LAFCo requesting the opinion of the CPUC regarding SSJID's proposal.

The CPUC relies on certain criteria to evaluate and make its determination concerning substantial impairment to PG&E's remaining ratepayers.

Resolution E-3952 addressed an annexation proposal by the Sacramento Municipal Utility District (SMUD) as requested by the Sacramento LAFCO. In that resolution, the CPUC determined that the following criteria were reasonable for evaluating a district's service proposal:

- a) whether the customers of the proposed district will be able to bypass payment of transition costs, which would require the remaining PG&E customers to cover these costs,
- b) whether any aspect of the district's proposal will potentially idle PG&E facilities requiring remaining PG&E customers to cover the costs of these idled facilities,
- c) whether there are any other quantifiable costs and/or offsetting benefits that would affect remaining PG&E customers, and

- d) whether the resulting cost impact, if any, would have a significant rate impact on remaining PG&E customers.

SSJID addressed the CPUC criteria in its proposal and determined that its acquisition of PG&E's distribution facilities and its provision of electric service will not adversely impact, and will likely benefit, PG&E's remaining electric customers.

SSJID states that 1) its newly acquired customers will not be able to bypass payment of transition costs or other NBCs, 2) it will not install distribution infrastructure that would result in idling PG&E's distribution facilities, and 3) the provision of retail electric service by SSJID will not have a significant rate impact on PG&E's remaining customers.

Furthermore, SSJID believes that it is likely that the change in service providers from PG&E to SSJID will reduce upward pressure on PG&E's retail rates going forward, providing net benefits to PG&E's remaining ratepayers. SSJID states that there are several reasons for this, including: (i) the transfer of load to SSJID will reduce PG&E's need to procure new resources to serve load in the near and long term; (ii) the load to be transferred to SSJID is "summer peaking" relative to PG&E's system average; thus, PG&E's additional future generation capacity needs in the summer will be reduced; (iii) the transfer of Central Valley load is growing at above-average rates but PG&E charges customers on a system average basis that does not take into account differentials in load growth across PG&E's system; (iv) the transfer of load to SSJID removes load that is currently paying less than full cost of service standards as measured by PG&E, thus reducing the cross-subsidy paid by other PG&E customers within SSJID's service territory; and (v) the transfer of load to SSJID reduces the need for PG&E investment in additional transmission capacity to ensure reliable delivery of power during the peak load (summer) season.

To perform its review, Energy Division asked for and received additional information from PG&E concerning SSJID's proposal to provide retail electrical service.

On January 19, 2006, the Energy Division requested that PG&E 1) address the criteria considered in Resolution E-3952, 2) respond to each SSJID assessment of costs and benefits to PG&E's remaining ratepayers, 3) provide quantitative impact estimates for each response with explanations of the calculations of such

estimates, and 4) provide supporting workpapers with its estimate of the rate impacts. PG&E responded to this inquiry on January 31, 2006.

NOTICE

The San Joaquin LAFCo's letter was noticed in the Daily Calendar.

San Joaquin LAFCo's letter, dated January 11, 2006, was received by the Energy Division on January 18, 2006 and noticed by publication in the Commission's Daily Calendar on January 23, 2006.

PROTESTS

PG&E urges the CPUC to issue a determination that SSJID's proposal will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

In its January 31, 2006 response to the Energy Division's request for information, PG&E asserts SSJID's proposal would 1) harm PG&E's remaining ratepayers by a 20-year Net Present Value (NPV) amount of \$232.1 million, increasing their rates by an estimated \$0.0004 per kWh, 2) result in the construction of additional facilities not otherwise needed, and 3) continue to remove customers from the CPUC's jurisdiction - continuing a trend that it believes promises to progressively hamper the ability of the state to achieve its energy policy objectives.

SSJID responds that PG&E's analysis is flawed and that SSJID's project will have no significant adverse effect on PG&E's remaining ratepayers.

SSJID submitted late-filed comments regarding PG&E's response on February 15, 2006¹. SSJID claims PG&E's response is incomplete, inconsistent, inaccurate and

¹ Comments were due by February 6, 2006. Although submitted late, SSJID's comments were succinct and thus were able to be considered and incorporated into the draft Resolution.

extremely misleading. As a result of errors and omissions, SSJID asserts PG&E's analysis significantly overstates the revenue it will lose, significantly understates the costs that it will avoid and benefits to remaining customers, and misconstrues the public policy implications of SSJID's plan.

DISCUSSION

Previous criteria are used to evaluate the effects of SSJID's proposal on PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

Our evaluation of SSJID's proposal to provide retail electric service relies on the criteria deemed reasonable in Resolution E-3952. Specifically, we consider a) whether SSJID's customers will be able to bypass payment of transition costs, which would require the remaining PG&E customers to cover these costs, b) whether any aspect SSJID's proposal will potentially idle PG&E facilities requiring remaining PG&E customers to cover the costs of these idled facilities, c) whether there are any other quantifiable costs and/or offsetting benefits that would affect remaining PG&E customers, and d) whether the resulting cost impact, if any, would have a significant rate impact on remaining PG&E customers.

Some customers in SSJID's proposed service area may be exempt from payment of certain transition costs and other NBCs which would require remaining PG&E customers to cover these costs.

All bundled service PG&E customers, non-exempt direct access customers, and non-exempt departing load customers located in SSJID's proposed service area currently pay a variety of transition costs and other NBCs. The ongoing competition transition charge (ongoing CTC), public purpose program (PPP) charge, nuclear decommissioning charge (NDC), and fixed transition amount/transition trust amount (FTA/TTA) charge were implemented to recover costs arising from electric industry restructuring. The Department of Water Resources bond charge (DWRBC) and the Department of Water Resources power charge (DWRPC) are for recovery of costs associated with power procurement during and after the energy crisis. PG&E's bankruptcy-related costs are captured in the energy cost recovery amount (ECRA) charge.

The applicability of these charges to Municipal Departing Load (MDL) (e.g. PG&E retail electric customers who depart to be served by SSJID) is governed by legislation and CPUC decisions². The net result with respect to SSJID's proposal is that all MDL customers served by SSJID would continue to be responsible for the ongoing CTC, NDC, FTA/TTA charge, and DWRBC but would be exempt from the PPP charge; some MDL customers would be excepted from the DWRPC and the ECRA charge.

PG&E and SSJID agree that some load to be served by SSJID may be exempt from certain charges but they disagree as to whether PG&E's remaining customers would have to cover any costs associated with the exemptions. SSJID states that there would be no cost shifting to PG&E's remaining customers because legislative and administrative exemptions were granted on the basis that certain loads did not contribute to the costs for which the charges were established. PG&E states that since customers who depart for SSJID service would have paid all of these charges in their entirety had they continued PG&E service, there is a loss of revenue associated with exemptions that adversely affects PG&E's remaining customers. PG&E estimates a \$34.8 million NPV adverse impact would result from these lost revenues.

In Resolution E-3952 regarding our evaluation of SMUD's annexation proposal, we concluded that PG&E's remaining ratepayers must cover the costs resulting from transition costs payment exceptions³. We understand SSJID's position that some CRS exceptions were justified in recognition of the fact that PG&E did not incur costs associated with certain departing loads. However, we reached the above conclusion on the basis that the overall cost obligation is fixed and that the remaining customers are left with the responsibility to pay those amounts resulting from any exceptions. Although this impacts PG&E's remaining

² See Assembly Bill 1890 and CPUC Decision (D.) 97-08-056, D.03-07-028, D.04-11-014, D.04-12-059, D.05-07-038, and D.05-08-035.

³ We specified that transition costs included the following components of the Cost Responsibility Surcharge (CRS): the DWRBC, the DWRPC, the ongoing CTC, and the ECRA charge. Although we excluded the FTA/TTA charge, NDC, and the PPP charge from our transition costs exception analysis, we did consider the impacts of exemptions from these NBCs in our discussion section regarding other costs/lost revenues.

customers and should be considered in our analysis here, it does not constitute cost-shifting as prohibited by Public Utilities (PU) Code § 366.2(d).

In addition to the CRS exception issue, SSJID asserts that PG&E's lost NBC revenues estimate is overstated because it ignores the expiration date of certain NBCs and fails to properly account for PPP revenues. Following a review of PG&E's workpapers supporting its calculations, we conclude that, with the exception of PPP costs, PG&E's lost NBC revenues estimate does account for the expiration date of the relevant NBC components. PG&E specifically calculates total rate percentages by customer class for MDL for the period 2007 through 2012, and calculates different ones for after 2012, to account for the fact that the ECRA charge and the DWRPC components will expire in 2012. Although PG&E stated that the PPP charge is also expected to expire in 2012, lost revenues associated with PPP charge exemptions are included throughout its 20-year forecasting period. SSJID asserts it is completely unreasonable to assume that PG&E will incur fixed PPP costs beyond 2012 since PG&E is not statutorily authorized to collect funds for PPP beyond that date. SSJID believes that including PPP charges only through 2012 reduces the estimated costs to PG&E's remaining customers by \$19 million on a NPV basis.

PU Code § 381 effective September 24, 1996, required public utilities to establish the PPP charge (formerly called the Public Goods Charge) to fund in part energy efficiency programs, renewable resource energy technology programs, and public interest research and development through the end of 2001. Funding for these programs through the PPP charge was extended through January 1, 2012 by PU Code § 399.8, effective January 1, 2002. Due to the importance of public purpose programs, it is reasonable to assume that the PPP charge will likely be extended again. Thus, it is conservative and appropriate for PG&E to include lost revenues from PPP charge exemptions in its total NBC lost revenue estimate.

SSJID additionally claims that it is inappropriate to include lost PPP revenues in its cost impact analysis because PPP costs are not fixed but rather should be managed to adapt to PG&E's slightly smaller customer base to ensure that PG&E's PPP expenditures benefit PG&E's remaining customers only. SSJID notes that it has included PPP costs in its own retail electric service pro forma and will implement its own PPPs for the benefit of the electric customers it will serve. PG&E will likely be able to conform PPP programs to accommodate a slightly smaller customer base to ensure that PG&E's remaining customers receive the benefits of its PPP expenditures. However, at this time it is unknown

the extent to which expenditure reductions are possible. Due to the uncertainty involved, we believe it is appropriate and reasonable to use PG&E's conservative estimates of lost PPP charge revenues for the purposes of quantifying lost NBC revenues.

There is a possibility that SSJID's severance proposal may idle some existing PG&E facilities requiring PG&E customers to cover the costs, however, the dollar impact depends on SSJID's precise plans which are unknown at this time.

SSJID states that it plans to acquire PG&E's existing electric distribution facilities to avoid duplicating and stranding PG&E facilities. As part of its acquisition plans, SSJID claims that some construction of facilities will be required to physically and operationally "separate" the facilities it intends to acquire from PG&E's remaining electric distribution system and to ensure that PG&E's remaining customers do not experience any degradation in service⁴. SSJID states that it also plans other facility construction in order to improve reliability and bring the system up to a reliability standard higher than the one PG&E currently meets, and is also working on contractual arrangements with PG&E and Modesto Irrigation District which it believes would provide efficiencies and minimize the need for some construction. SSJID asserts that the construction and installation of its proposed facilities will not result in the idling of any PG&E distribution facilities.

PG&E, on the other hand, asserts that the associated distribution and/or transmission facilities throughout SSJID's proposed service area would become idle or altered in the process of completing necessary severance work. The specifics, PG&E claims, depends upon SSJID's precise plans which are not known at this time. As an example, PG&E states if SSJID opts to take possession of PG&E's Manteca substation, it claims it would be necessary to relocate PG&E's transmission facilities (at SSJID's expense), as the site cannot accommodate a bifurcation of the facilities, and the transmission facilities are necessary for PG&E customers outside the proposed SSJID service area. However, if SSJID chooses to

⁴ SSJID anticipates constructing a least one new substation, installing new transformers in some acquired substations, and installing new distribution lines and feeders in certain areas.

construct its own substation to serve the Manteca area, then there will be duplication and the facilities within PG&E's Manteca substation would become idle.

Our relevant criterion is whether any aspect of the district's proposal will *potentially* idle PG&E facilities requiring remaining PG&E customers to cover the costs of these idled facilities. Because the specifics of the proposal have not yet been determined, there is the *potential* that some PG&E facilities may be idled. Unfortunately, due to this uncertainty PG&E did not quantify any impact and thus we cannot rely upon any such estimate in our evaluation.

There could be costs resulting from lost T&D revenues that could affect remaining PG&E customers.

In addition to the lost NBCs revenues discussed above, PG&E states that its remaining ratepayers would be adversely affected by lost T&D revenues that PG&E would have collected from the customers in the proposed SSJID service area.⁵ These lost revenues would be offset partly by the compensation ultimately provided by SSJID for the T&D assets. Using an asset valuation figure of \$52 million (which PG&E states represents an amount close to the book value), PG&E estimates the total losses in T&D contribution to margin to be \$197.3 million NPV. SSJID states that the use of this asset valuation figure does not reflect the valuation figure used by SSJID (\$50 million to \$80 million) nor does it reflect what PG&E has publicly claimed the acquisition will cost (\$205 million). If PG&E's own estimate is used instead of the book value price, SSJID asserts the impact to PG&E's remaining customers would be reduced by \$153 million on a NPV basis using the methodology employed by PG&E.

We acknowledge that there is a range of possible outcomes depending on the actual asset valuation determination and the disposition of any gain on sale, however, given the uncertainty, it is conservative to use the number that would yield the greatest possible adverse impact on PG&E's remaining ratepayers when making a determination of whether there is substantial impairment.

⁵ PG&E notes that it would avoid some T&D costs should the SSJID's proposal move forward, however, it expects the lost revenue to exceed the avoided costs, so that contribution to margin would decrease.

SSJID believes there are also other errors and omissions in PG&E's analysis which lead to an overstatement of the T&D revenues that it will lose. For example, SSJID states that it is incorrect for PG&E to assume that PG&E will lose all transmission related revenues associated with the customers SSJID intends to serve because SSJID plans to take a majority of its transmission service from PG&E. Thus, SSJID argues the only difference will be that PG&E will receive such revenues from SSJID under PG&E's wholesale transmission service tariff rather than from retail customers through the transmission component of its retail rates. SSJID alleges PG&E fails to fully account for the transmission related revenues it will receive from SSJID.

Although PG&E's disagrees, it ran a sensitivity case conservatively assuming 100 percent of the transmission service would be provided by PG&E. Due to the difference in rates between wholesale and retail customers, PG&E states that its overall 20-year NPV lost contribution to margin estimate would decrease by \$36 million (from \$197.3 million to \$161.3 million).

The amount of transmission service that SSJID will be taking from PG&E is unknown at this time. In its proposal, SSJID states that it will take "a *significant portion* of its load" from PG&E owned transmission facilities, but it also states that it will take "*some* transmission service through the Western Area Power Administration Control Area." (Supplement, p.1, emphasis added). Quantifying the dollar impact associated with the terms "significant" and "some" is difficult. Clearly, it is not appropriate to assume that none of the transmission service would be supplied by PG&E (as PG&E has) nor is it appropriate to assume that SSJID will be taking all of its transmission service from PG&E (as SSJID asserts). When considering the possible impact on PG&E's remaining ratepayers, it is reasonable to assume that "a significant portion" means SSJID will take at least half of its of its transmission service from PG&E. Accordingly, PG&E's lost T&D contribution to margin estimate could be reduced to \$179.3 million NPV⁶.

⁶ Since we were unable to run a 50 percent transmission service sensitivity case, we simply divided in half PG&E's 100 percent transmission service sensitivity case result to arrive at an \$18 million reduction to PG&E's original NPV lost contribution to margin estimate. We recognize this approach lacks precision however, it should yield an estimate that is closer to the actual scenario.

Although the amount of load departure resulting from SSJID's proposal may be within the range of forecasting uncertainty, it does not negate the cost impact analysis.

SSJID claims that the amount of load it would take is: a) small relative to the total load that PG&E has forecast will depart its system, b) is within the range of uncertainty in PG&E's forecasts, c) is not at risk to return (unlike direct access or community choice aggregation load), and d) is easier to predict than direct access load. SSJID also argues that future load uncertainty caused by its takeover plans can be easily managed by PG&E's portfolio, and that SSJID is not the only publicly owned utility planning to shift load from PG&E.

PG&E responds that even if it were able to perfectly predict whether SSJID will actually implement its plan (and the exact date at which it would effectuate its take-over) and plan accordingly to minimize stranded procurement costs, that does not mean that PG&E's ratepayers would not be harmed by the loss of NBC revenues and T&D contribution to margin that would result.

There is no doubt uncertainty is inherent in future sales, loads and resource procurement forecasts; however, this type of uncertainty does not change our cost impact analysis. To provide electric service, PG&E makes large up-front investments in generation, transmission and distribution infrastructure, which going forward then become fixed costs. Rates are then set to cover variable operating costs plus an amount that goes toward amortizing the fixed costs over time. PG&E's model shows that customers in SSJID's proposed service area are making a positive contribution to margin, i.e. paying revenues in excess of marginal costs and thus helping to amortize fixed costs. If these customers are lost, then PG&E's remaining customers will have to contribute more (in the form of higher rates) in order for fixed costs to be amortized on schedule. We find that PG&E's analysis, as modified above, conservatively quantifies these effects on its remaining ratepayers.

To the extent PG&E agrees there are quantifiable avoided costs, it credits them as a benefit to PG&E's remaining ratepayers. SSJID has offered some claims of additional net benefits to PG&E's remaining ratepayers with quantitative analysis that could further reduce the impact on PG&E's remaining ratepayers.

SSJID states that a shift in load from PG&E to SSJID, as provided for in its proposal, will likely benefit PG&E's remaining customers. Specifically, SSJID asserts that 1) PG&E's remaining customers will benefit from any gain on sale related to SSJID's acquisition of PG&E's distribution facilities, 2) SSJID's proposal will help PG&E achieve needed load reductions at no cost to PG&E's ratepayers, 3) shifting load to SSJID will reduce PG&E's need to procure new resources, 4) reducing PG&E's need to procure new resources should help reduce the need to increase PG&E's authorized cost of capital to account for "debt equivalency", 5) shifting load to SSJID will reduce current cross-subsidies in PG&E's rate structure that favor residential and Central Valley loads at the expense of other PG&E customers, and 6) SSJID's proposal will reduce a current risk faced by PG&E that customers will depart PG&E service for Modesto Irrigation District, idling existing PG&E facilities.

We stated in our evaluation criteria that it is reasonable to consider "quantifiable costs and/or offsetting benefits that would affect remaining PG&E customers". In its response to SSJID's above assertions, PG&E readily acknowledges that some costs would be avoided if its facilities are condemned and it no longer is serving customers in the SSJID area. To that extent, PG&E states it has quantified these avoided costs over a 20-year study period and explicitly credits the estimates as a benefit to PG&E's remaining ratepayers. SSJID claims there are additional quantifiable benefits beyond those captured by PG&E. Specifically, SSJID asserts that PG&E's analysis should account for additional savings resulting from a reduction in PG&E's ratebase to reflect the actual acquisition price, including interest costs, return on equity, and income taxes on the return on equity. SSJID estimates these "return on rate base savings" will be approximately \$18 million assuming an acquisition cost of \$52 million, and approximately \$69 million NPV assuming an acquisition cost of \$205 million.

SSJID also asserts that PG&E fails to account for substantial future power procurement savings that will result from SSJID's proposal. While SSJID has not quantified the exact amount, it estimates that PG&E's remaining customers would see an additional \$115 million NPV⁷ in benefits as a result of SSJID's

⁷ SSJID's estimates that the generation costs included in PG&E's current system average bundled rates (\$73/MWh) are *less than* PG&E's estimate of the marginal cost to procure power in the market in 2006 (\$95/MWh). Given that SSJID expects that PG&E's

proposal. SSJID also asserts that PG&E failed to consider the future customer growth PG&E will experience over the next 20 year and its ability to adjust its operations to reflect its actual customer base, including the loss of customers to SSJID. SSJID, however, does not support such claims with any quantitative analysis.

It is possible that SSJID's proposed service will raise rates for PG&E's remaining ratepayers but the magnitude of any estimated increase is small compared to current system average rates, and thus does not substantially impair PG&E's ability to provide adequate service at reasonable rates.

To estimate the total impact on remaining PG&E customers, PG&E added together its \$34.8 million estimate of lost NBC revenues and its \$197.3 million of lost T&D contribution to margin (offset by the net book value benefit), for a total impact of \$232.1 million NPV over the 20-year study period. On an annualized basis, PG&E estimates its remaining ratepayers would be harmed by an estimated \$22.9 million per year. This figure, divided by the 2007 estimated annual sales, would yield an estimated rate increase to its remaining ratepayers of \$0.00037 per kWh.

SSJID believes PG&E's analysis is a "worst case scenario" that does not properly account for factors it believes will mitigate any adverse impacts on PG&E's remaining customers. If potential acquisition prices are properly considered and other factors are taken into account, SSJID states the potential rate impact on PG&E's remaining ratepayers may vary from an increase of \$0.00025 per kWh to a *reduction* of \$0.00017 per kWh.

marginal cost to procure new resources is *greater* than the average generation costs recovered from PG&E's bundled customers, it estimates the savings from reduced procurement costs will be greater than PG&E's loss of generation revenues and thus, PG&E's remaining customers should *benefit* under SSJID's proposal. Moreover, SSJID asserts that since SSJID's service territory represents approximately 140 MW of summer peaking load, the benefits associated with such avoided procurement costs should be substantial. If the difference in generation costs (\$22/MWh in 2006) were to continue for 20 years (the time period used in PG&E's analysis), SSJID estimates PG&E would see an additional \$115 million NPV benefits.

Depending on the assumptions, there is a range of possible rate impacts. When evaluating possible scenarios (in the absence of known facts), it is reasonable to use the highest quantifiable number when determining whether there is the possibility that the proposed service will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory. In this case, the largest reasonable estimate would result in a rate increase of \$0.00035 per kWh, which is approximately only ¼ of a percent of PG&E's current system average rates⁸. We note that a rate impact of this magnitude, does not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

Broader energy policy implications are beyond the scope of the analysis required in this Resolution; such implications should be considered in a generic CPUC proceeding and a statutory change should be made to expand the scope of future CPUC reviews.

PG&E claims that SSJID's project will result in the loss of CPUC jurisdiction and implies that this will undermine State public policies. SSJID responds that it believes PG&E's claim is incorrect and that it is irrelevant to the issues the CPUC must address under Government Code § 56131. SSJID states that it has been subject to public policy initiatives adopted by the Legislature and will continue to be subject to such initiatives, including state energy policies. SSJID further notes that it owns qualifying renewable resources which as a percentage of its load exceeds current CPUC renewable portfolio standard requirements.

In Resolution E-3952, dated November 18, 2005, we determined that the consideration of broader energy policy issues related to the formation or expansion of public power within a public utilities' service territory is beyond the scope of the CPUC's inquiry under Government Code § 56131 but could be the subject of a separate CPUC proceeding. In Resolution E-3959, dated December 15, 2005, we further elaborated that municipal utilities, municipal districts, and irrigation districts are not subject to the same requirements as utilities regulated by the CPUC regarding implementation of the state's energy policies, such as the greenhouse gas adder, the Renewables Portfolio Standard,

⁸ PG&E's current system average rate for bundled service customers is 13.893 cents per kWh for rates effective March 1, 2006, as shown in PG&E's Advice Letter 2791-E.

the California Solar Initiative, and other activities related to climate change. We specifically noted that Government Code § 56131 is narrowly drawn and does not provide for us to conduct an analysis of whether public power expansion proposals are consistent with the state's energy policies. Nor does the statute provide for us to conduct an analysis of whether and to what extent the economic feasibility of providing utility service pursuant to an expansion proposal is driven by the ability of a non-regulated utility to escape the cost of implementing Energy Action Plan II policies. With the goal of adopting a general policy statement, we stated that we might consider such issues in PG&E's test year 2007 General Rate Case (GRC), A.05-12-002. On February 3, 2006, an Assigned Commissioner's Ruling and Scoping Memo for that proceeding was issued which found that these issues are better suited to be considered for all utilities generically rather than in PG&E's 2007 GRC. The initiation of a generic proceeding, such as an Order Instituting Rulemaking, is pending.

In addition, we have endorsed and are seeking a statutory change to expand Government Code § 56131 to require the CPUC to consider the cumulative impacts of public power expansion proposals. Additionally, we are seeking changes to consider the effect multiple proposals may have on the efficiency of the public utilities' programs to implement state energy policy goals and priorities on energy efficiency, renewable portfolio standards, the use of solar energy, and resource adequacy, among others.

COMMENTS

Per statutory requirement, a draft resolution was mailed to parties for comment at least 30 days prior to consideration by the CPUC.

PU Code § 311(g)(1) provides that a draft resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the CPUC. Accordingly, a draft resolution was mailed to parties for comment. PG&E, SSJID, and SMUD submitted opening comments on April 3, 2006. On April 7, 2006, PG&E replied to SSJID's and SMUD's opening comments, and SSJID replied to PG&E's opening comments.

No modifications to the draft resolution are necessary in response to PG&E's opening comments.

PG&E states that the draft resolution concludes that PG&E's analytical approach, which involves calculating the lost contribution to margin resulting from SSJID's proposed service, is an appropriate evaluation methodology. PG&E also states that the draft resolution correctly concludes (a) that PG&E's analysis already accounts for any avoided costs resulting from SSJID's service; and (b) that SSJID's claims of additional net benefits to PG&E's remaining ratepayers lack supporting quantitative analysis.

Although PG&E believes the NPV impact of SSJID's proposed service is likely to be slightly more adverse to PG&E's remaining ratepayers than the draft resolution concludes (PG&E estimates lost T&D CTM at \$232.1 million NPV versus the draft resolution's estimate of \$214.1 million NPV), PG&E believes the draft resolution's estimate is roughly correct. Finally, PG&E appreciates the inclusion of language in Finding 12 of the draft resolution which clearly states that, although not judged to rise to the level of "substantial impairment," SSJID's proposed service would nevertheless result in a likely rate increase to PG&E's remaining ratepayers.

PG&E also states, however, that as with the previous resolutions, the analysis in the draft resolution adopts what PG&E believes to be a narrow interpretation of Government Code § 56131 and concludes that the Commission cannot consider either the cumulative effects of SSJID's proposed service (when viewed in conjunction with the previous proposals, as well as known public power efforts on the horizon) or the policy leakage issues. The draft resolution notes that the CPUC intends to take steps such that it will be in a position to broaden the scope of its review to include other impacts associated with the type of publicly owned utility activity represented by SSJID's proposal. PG&E states that it looks forward to supporting the CPUC in this regard, given the important role that the CPUC can play on these important policy matters.

SSJID replies that it believes that Government Code § 56131 expressly limits the scope of the CPUC's review of whether a proposal will substantially impair a public utility's ability to provide service at reasonable rates, nevertheless, it supports the establishment of a generic CPUC proceeding to consider the methodology used by the CPUC to review proposals under this statute.

PG&E's comments affirm the evaluation methodology and conclusions of the draft resolution. Accordingly, no changes were made as a result of PG&E's opening comments.

Although certain clarifying changes were made to the draft resolution concerning the impact analysis resulting from CRS exceptions, the overall conclusion remains the same.

SMUD disagrees with the draft resolution's conclusion that any CRS exemptions applicable to SSJID customers will result in cost impacts to PG&E's remaining customers. SMUD requests that the draft resolution be modified to reflect that load that takes service from SSJID does not cause PG&E's remaining ratepayers to assume costs, consistent with CPUC decisions authorizing MDL CRS exemptions.

PG&E replied that this was the very same issue that arose in the debate leading to Resolution E-3952 concerning SMUD's proposed service in Yolo County. PG&E asserts that SMUD made the same arguments there and lost. PG&E states that SMUD appears to be trying to use its comments here to revise that earlier resolution, which is procedurally inappropriate.

As PG&E points out, SMUD's comments on this issue merely reargue both its position that was fully considered in Resolution E-3952 as well as rearguing SSJID's position that was considered and articulated in the draft resolution. Although the draft resolution's conclusion is consistent with the conclusion reached in Resolution E-3952 regarding the same issue, it has been revised slightly to clarify certain terminology.

No changes have been made to the discussion in the draft resolution concerning the CPUC's statements and plans related to instituting a proceeding and seeking legislation regarding public power policy issues.

SMUD claims that the draft resolution goes further than the two most recent resolutions issued pursuant to Government Code § 56131 (i.e. Resolutions Nos. E-3952 and E-3959), suggesting that the provision of power by publicly owned utilities may be inconsistent with the state's energy policies. SMUD urges that, if CPUC considers broader policy issues associated with public power through a new rulemaking or legislative proposals, it carefully consider the current statutory framework, which contemplates electric service by both publicly and

privately owned utilities, as well as the many formal policies and programs the governing bodies of California's publicly owned utilities implement that are consistent with the state's energy policies.

PG&E replied that it believes that there is nothing inaccurate in the draft resolution. PG&E states that publicly owned utilities consistently tell the CPUC that they are not under its jurisdiction, and consistently lobby in Sacramento for watered-down requirements that would exempt them from the requirements that apply to the investor owned utilities.

With the exception of offering additional information concerning the CPUC's recent efforts to seek legislative changes to consider broader energy policy issues, this draft resolution does not go beyond statements made in prior Resolutions Nos. E-3952 and E-3959. Accordingly, the draft resolution has not been modified; it remains the intention of the CPUC to issue a Rulemaking and in doing so will carefully consider all relevant issues.

The draft resolution has been revised to state that although the actual asset valuation figure is not known, there are there are other possible outcomes that could reduce the cost impact analysis figures accordingly.

SSJID asserts that the single most important factor affecting the impact of SSJID's proposal on PG&E's remaining customers is the price SSJID will pay to acquire PG&E's facilities. In estimating this impact, the draft resolution accepts what PG&E claims is SSJID's asset valuation figure, as well as PG&E's analysis of how that acquisition price will affect the cost of service for PG&E's remaining ratepayers. SSJID asserts that the acquisition price used by PG&E in its analysis (\$52 million), however, does *not* reflect the valuation figure used by SSJID in its LAFCo application (\$50 million - \$80 million) nor does it reflect what PG&E has publicly claimed the acquisition will cost (\$205 million). SSJID argues that if PG&E's estimate is used instead of the much lower value assumed in the draft resolution, the impact on PG&E's remaining customers would be reduced by \$153 million on a NPV basis using the methodology employed by PG&E (and accepted in the draft resolution). Accordingly, SSJID states that the draft resolution should acknowledge that the actual acquisition cost may vary widely.

The draft resolution did use what PG&E claimed was SSJID's asset valuation figure of \$52 million representing slightly more than book value. PG&E used that figure in its analysis even though PG&E believes it is entitled to a much

higher current fair market value. The draft resolution used the lowest number available because when calculating impacts on PG&E's remaining ratepayers, it is conservative to use the number that would yield the greatest possible adverse impact. The draft resolution, however, should have acknowledged that the actual number is not known and as a result, there are other possible outcomes that could reduce cost impact analysis figure accordingly. The draft resolution has been revised to state the range of possible outcomes.

Other than a revision to expand upon the discussion of SSJID's position, no changes have been made to the draft resolution to make a determination regarding the disposition and/or accounting of any gain on sale.

SSJID asserts that if actual acquisition price for PG&E's facilities is greater than the book value, there would be a gain on sale that should benefit PG&E's remaining customers. SSJID states that the draft resolution fails to account for any such gain on sale, however, even though both PG&E and SSJID have stated that the acquisition price for PG&E's facilities will likely be greater than the book value of the facilities. As a result, SSJID asserts that the draft resolution significantly distorts the impact SSJID's proposal will likely have on the rates for PG&E's remaining customers.

In response, PG&E states that SSJID confuses acquisition price with benefits to ratepayers. PG&E agrees that there will be benefits to ratepayers from a reduction in rate base, but it states its analysis accounts for this by crediting ratepayers with the book value. PG&E asserts that under the CPUC's *Redding II* policy, any gain (or loss) resulting from the sale of its facilities would go to PG&E's shareholders, not ratepayers. PG&E asserts that since the results are independent of the ultimate acquisition price, SSJID's arguments are incorrect because they rely on the false premise that PG&E's ratepayers would lose less if the acquisition price turns out to be higher.

Neither PG&E nor SSJID has discussed in any detail the proper disposition of any gain on sale in light of existing CPUC precedent or the pending decision in the gain on sale rulemaking (R. 04-09-003). Accordingly, we do not even attempt to determine the proper disposition of any gain on sale but revise the draft resolution to acknowledge SSJID's position that it is possible that any such gain may reduce negative impacts on PG&E's ratepayers.

The draft resolution has been revised to reflect SSJID's additional statements of possible quantifiable benefits associated with the reduction in PG&E's rate base and related costs that may further reduce the impact on PG&E's remaining ratepayers.

SSJID alleges that the draft resolution also fails to account for the benefit to PG&E's remaining customers that can result from a reduction in PG&E's rate base to reflect the acquisition price paid for the facilities. Such a reduction in rate base it asserts will, in turn, reduce return on rate base costs over time, including interest costs, return on equity costs, and income taxes on the return on equity, for PG&E's remaining customers. SSJID estimates that these "return on rate base savings" will be approximately \$18 million NPV assuming an acquisition cost \$52 million, and approximately \$69 million NPV assuming an acquisition cost of \$205 million.

The draft resolution has been revised to include discussion regarding the consideration of these return on rate base savings and cite SSJID's range of possible outcomes utilizing the various acquisition cost assumptions.

The draft resolution has been revised to include additional assertions offered by SSJID concerning assumptions regarding operational adjustments and customer projections.

SSJID asserts that PG&E should be able to adjust its operations to account for changes in its customer base, and that normal customer growth over the next few years could, in and of itself, completely offset any impacts related to the loss of customers to SSJID.

PG&E believes that these assertions are incorrect. PG&E replied that its analysis assumes increased customer growth and sales, as reflected in its workpapers. But even assuming *arguendo* that it did not, PG&E states that it would be incorrect to conclude ratepayers would not be harmed by SSJID's proposed service because the sales growth will benefit remaining ratepayers regardless of whether or not SSJID proceeds with its proposal. If SSJID does not proceed, though, PG&E asserts that ratepayers would receive the benefit of growth plus they would not lose the CTM associated with these lost customers.

Although the draft resolution was revised to reflect SSJID's additional assertions, they were not considered further (and thus PG&E's concern regarding ratepayer

impacts was not addressed) because SSJID did not provide any supporting quantitative analysis.

With the exception of stating SSJID's position regarding the period for which PPP costs should be included, no changes to the draft resolution are warranted.

SSJID believes the draft resolution fails to properly account for PPP costs because it assumes that PG&E's remaining customers will be responsible for PPP costs for the next 20 years, even though the statute authorizing the collection of PPP charges sunsets in 2012. Even assuming (no matter how unrealistic) that PG&E cannot adjust its operations to account for changes in its actual customer base over the next 20 years, SSJID asserts it is completely unreasonable to assume that PG&E will incur fixed PPP costs beyond 2012 since PG&E is not statutorily authorized to collect funds for PPP beyond that date. SSJID believes including PPP charges only through 2012, reduces the estimated costs to PG&E's remaining customers by \$19 million on a NPV basis. SSJID's position is that even if in the future, the sunset date for PPP is extended beyond 2012, there would be no legitimate reason for PG&E to incur any cost obligations attributable to SSJID customers given that PG&E will not be providing service to these customers in the future.

PG&E replied that since the statute has already been extended twice since it was enacted in 1996, PG&E assumed it will continue to be extended. PG&E states that it sees no change in the political/regulatory climate that would lead it to believe otherwise. Infact, PG&E believes that it is being conservative since policymakers seem inclined to increase PPP funding for things like energy efficiency, low income rates, etc.

The draft resolution noted that it is reasonable, due to the importance of public purpose programs, to assume that the PPP charge will likely be extended beyond its current expiration date again. Thus, it is conservative and appropriate for PG&E to include lost revenues from PPP charge exemptions in its total NBC lost revenue estimate. Although no changes to the outcome were warranted, text was added to expand upon SSJID's position and to include its estimated quantitative impact.

The draft resolution has been revised to reflect SSJID's estimate of future procurement costs that it believes could be avoided as a result of SSJID's proposal.

SSJID alleges that the draft resolution fails to account for a benefit to PG&E's remaining customers that will result from SSJID's proposal relieving PG&E of the obligation to procure resources to serve electric customers in SSJID's service territory.

PG&E replied that SSJID's method of quantifying the impact is incorrect as it relies on faulty assumptions.

Due to the fact that SSJID now offers quantitative analysis in support of its earlier claims, the draft resolution has been revised to reflect the additional information. However, as it only a citation to SSJID's position and its estimate of a possible benefit, it is not necessary to argue the merits of SSJID's assumptions.

The draft resolution has been revised to include SSJID estimates and citations of the ranges of possible rate impacts (to the extent they have been quantified).

SSJID's initial claims of additional net benefits to PG&E's ratepayers beyond those identified by PG&E (provided in its comments on PG&E's response to the Energy Division's request for information), lacked supporting quantitative analysis. In its comments on the draft resolution, SSJID provided estimates and a range of possible outcomes that it believes the CPUC should consider in its rate impact analysis. To the extent SSJID has provided quantitative analysis to supplement its position, the draft resolution has been revised to reflect the inclusion of SSJID's estimates.

The draft resolution has been revised to indicate that a rate increase is "possible" rather than "likely".

SSJID alleges that the draft resolution erroneously presumes that the CPUC can make a definitive finding of the likely rate impact of SSJID's proposal and incorrectly concludes that the rates for PG&E's remaining customers will likely increase.

We recognize that the numbers provided by the parties to determine whether SSJID's proposed service would substantially impair PG&E's ability to provide

service at reasonable rates are estimates. And, depending on the assumptions, there is a range of possible rate impacts. This resolution maintains that when evaluating possible scenarios (in the absence of known facts), it is reasonable to use the highest quantifiable number when determining whether there is the possibility that the proposed service will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory. With ambiguities present, however, there is no basis, for the CPUC to conclude that any of these potential outcomes is more "likely" than any other. As a result, the relevant text and related finding have been modified to indicate that a rate increase is a possibility rather than a likelihood.

FINDINGS

1. SSJID submitted an application to the San Joaquin LAFCo proposing to provide retail electric service to approximately 40,000 existing PG&E customers.
2. Under Government Code § 56131, the CPUC must investigate and submit a report to the LAFCo within 90 days stating whether, in its opinion, SSJID's proposal within PG&E's service territory will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service area.
3. On January 18, 2006, the Energy Division received a letter, dated January 11, 2006, from the San Joaquin LAFCo requesting the opinion of the CPUC regarding SSJID's proposal.
4. In prior resolutions addressing LAFCo requests, the CPUC has considered the following criteria for evaluating the statutory provision: a) whether the customers of the proposed district will be able to bypass payment of transition costs, which would require the remaining PG&E customers to cover these costs, b) whether any aspect of the district's proposal will potentially idle PG&E facilities requiring remaining PG&E customers to cover the costs of these idled facilities, c) whether there are any other quantifiable costs and/or offsetting benefits that would affect remaining PG&E customers, and d) whether the resulting cost impact, if any, would have a significant rate impact on remaining PG&E customers.

5. SSJID asserts that its acquisition of PG&E's distribution facilities and its provision of electric service will not adversely impact, and will likely benefit, PG&E's remaining electric customers.
6. PG&E asserts that SSJID's proposal will harm PG&E's remaining ratepayers by increasing their rates, and will substantially impair its ability to provide adequate service at reasonable rates within the remainder of its service territory.
7. Some customers in SSJID's proposed service area may be exempt from payment of certain transition costs and other NBCs which would require remaining PG&E customers to cover these costs.
8. There is a possibility that SSJID's severance proposal may idle some existing PG&E facilities requiring PG&E customers to cover the costs, however, the dollar impact depends on SSJID's precise plans which are not known at this time.
9. There could be costs resulting from lost T&D revenues that could affect remaining PG&E customers.
10. Although the amount of load departure resulting from SSJID's proposal may be within the range of forecasting uncertainty, it does not negate the cost impact analysis.
11. To the extent there are quantifiable avoided costs, PG&E credits them as a benefit to PG&E's remaining ratepayers. SSJID claims of additional quantifiable net benefits to PG&E's remaining ratepayers could further reduce the impact on PG&E's remaining ratepayers.
12. It is possible that SSJID's proposed service will raise rates for PG&E's remaining ratepayers but the magnitude of any estimated increase is small relative to PG&E's current system average rates, and thus does not substantially impair PG&E's ability to provide adequate service at reasonable rates.
13. Broader energy policy implications are beyond the scope of the analysis required in this Resolution; such implications should be considered in a

generic CPUC proceeding and a statutory change should be made to expand the scope of future CPUC reviews under Government Code § 56131.

THEREFORE IT IS ORDERED THAT:

1. A certified copy of this Resolution shall be mailed to the Executive Officer of the San Joaquin Local Agency Formation Commission.
2. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 13, 2006; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners